



## **Transparency and disclosure between theory and practice. A case study of Romania**

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*As a modern system by which companies are directed and controlled (The Cadbury Report, 1992) – corporate governance have became in the last years a system implemented by more and more companies from developed countries and recently from developing once. Having as starting point one of the principles of corporate governance – transparency – in this paper we focus on aspects that contribute to reach the transparency at corporate level, taking into consideration both regulation and practical issues in Romania, a developing country that have recently adopted the mechanisms of corporate governance.*

*Corporate disclosure is the principal mean by which companies can become transparent, and is critical for the functioning of an efficient capital market (Healy & Palepu, 2001). For this reason we investigate several non-financial items that companies operating on international capital markets are usually disclosing, looking for the extent to which Bucharest Stock Exchange listed companies are disclosing corporate social responsibility information. The results suggest that is a poor disclosure of social responsibility information within the annual reports even the companies are activating in domains with great impact on the environment.*

*Keywords: corporate governance, transparency, corporate disclosure, listed companies, corporate responsibility*

*JEL codes: M41, G32*

## 1 Introduction

One of the basic principles for the well-functioning of corporate governance (CG) system is transparency. Disclosure is the principal mean by which companies can become transparent (Solomon, 2007). Because CG purpose is to serve the stakeholders to become better informed, the role of disclosure is important no matter of the disclosure form: mandatory or voluntary, financial or non-financial.

Corporate governance and accountability developments aware companies about the responsibilities they should have towards all their's stakeholder groups, to the environment and society. In the last decades, the social role of the firm has come under increasing scrutiny (Allouche, 2006). The changes in the international business environment have imposed reviews in the nature and content of the corporate reporting. The concepts like "sustainable development", „corporate sustainability“, „corporate social responsibility“ has revolutionized reporting. The later trends in business reporting have put in the front line the importance of non-financial disclosure and the growing needs of the potential shareholders that expect any company in which they invest to meet certain minimum standards in terms of governance and disclosure.

In this evolving international context, the aim of our paper is to explore social responsibility reporting within the annual reports of Romanian listed companies. To achieve this goal we carried out a thorough investigation of the companies listed on Bucharest Stock Exchange (BSE) and data from all the these entities have been collected.

The main contributions of this article consists in the study of the corporate governance, disclosure and sustainability reporting in a country where this concept has known a poor development till recent years and companies that have embraced it were in a pioneering phase in their reporting policy. First of all, it tries to give an insight look of Romanian theoretical background on corporate social responsibility and shapes several key issues regarding sustainability development. Secondly, this study intends to bring an explanatory contribution to the development of social responsibility by building a research design based on several disclosed items concerning CSR practices for Romanian listed companies. Thirdly, our paper contributes to the few articles from domestic accounting literature written on the topic of disclosure that link the theoretical framework with empirical research performed on companies listed on the Romanian market.

The study is divided in two parts. The first part consists of two sections and presents the theoretical background: the basic theories for corporate governance and disclosure, the corporate sustainability and social responsibility concepts. The second part represents the empirical study based on the analytical investigation of the extent of social responsibility reporting within the annual reports of Romanian companies. In the end of the paper it can be found the concluding remarks and directions for further research.

## 2 Theoretical aspects

### 2.1 Theoretical background regarding corporate governance and disclosure

The modern stakeholders needs for information are more sophisticated, they ask for more information than the one provided by the financial statements. Nowadays, these stakeholders are valuing the company not only by financial numbers but also by its nonfinancial and strategic performance. The annual reports are now seen as the primary source of corporate information disclosure. Additionally to mandatory information annual reports may also provide voluntary information, The efficiency of disclosure process is dependent upon the needs of the stakeholders and of the interests of the management of the corporation (Debreceeny, Gray, Mock, 2001). Hence, disclosure is a crucial element in ensuring the effective allocation of resources in society and diminishing the information asymmetry between company and its stakeholders. Descriptive, analytical and empirical studies in accounting have been interested in the last decades in the incentives of companies to voluntarily disclose information.

Research on voluntary disclosure choices or factors influencing the extent of voluntary disclosure, using Romanian context is still very rare. To our best knowledge, only a few authors investigated this issue. Popa et al. (2008a) have performed a descriptive quantitative study on internet disclosure and its determinants, Ionascu et al. (2008) have conducted a qualitative research about disclosure regulations and the cost of capital for Romanian companies. Popa et al. (2008b) have investigated the level of using internet advantages by Romanian companies. While Tiron Tudor (2006), focused on disclosure of Romanian companies, searching to find out the practices of these companies regarding the Internet Financial Reporting.

The practice of voluntary disclosure is usually explained by two economic-based theories: agency theory and signalling theory or information problem theory. *Agency theory* is frequently used to analyze the determinants of accounting choices. Starting from Jensen and Meckling (1976) pioneering work many authors explain disclosure policy by agency theory. Financial statements in opinion of Prabowo and Angkoso (2006) are one main device to reduce the agency problem, although there are other mechanisms such as efficient market for corporate control, governmental regulation, efficient job market for managers and managerial stock ownership program. As Healy and Palepu (2001) and Botosan and Plumlee (2002) considered it is expected that by disclosing additional, not mandated information, managers and owners can actually reduce agency costs.

On the other hand, *signalling theory* completes the explanation of corporate disclosure. Akerlof (1970) sees information asymmetry as a „lemons” problem that arises when a person wants to buy a used car. Seller knows more than the buyer. This difference in information about the product is the information asymmetry between the buyer and seller. In capital markets the „lemons” problem scenario can be compared with the problem that emerges when a company goes public. The present owners of the initial public offerings (sellers) know more about the firm (product) than potential

investors (buyers). Disclosing more financial and non-financial information to potential investors can reduce the information problem.

Corporate disclosure policy regarding sustainability at corporate level is based on the principles of voluntary disclosure.

## 2.2 The concepts of corporate sustainability and social responsibility

Because in the recent years “*sustainability development*” (SD) keeps attention of different international organizations, business and academic environment we stop on this issue. The disclosure of CSR information is based on the stakeholders’ behaviour and the disclosure theories that we have presented briefly in the previous section.

Representing a broad concept “sustainable development” was for the first time defined in 1987, by the United Nations World Commission on Environment and Development (WCED). WCED describes sustainable development as “development that met the needs of present generations without compromising the ability of future generations to meet their needs”, it is “a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations.” SD is a multidisciplinary concept that combines economics, social justice, environmental science and management, business management, politics and law (Ebner and Baumgartner, 2006) and has three bottom lines: economical, environment and social policies.

*Corporate sustainability* sets out the company’s performance areas and strategies focused on environmental protection, social justice and equity and economical development. The four pillars of CS are represented by the directions traced by the concepts of sustainable development and corporate social responsibility and the two theories: stakeholder theory and corporate accountability theory.

The *Corporate Social Responsibility* assumes that companies should have obligations (Bowen, 1953 cited in Carroll 1999), should follow lines of action compatible with the “values of society” and McGuire (1963) stated that economic and legal duties of companies should be extended to some society responsibilities. Later, Carroll (2004) presented the four components of social responsibility: economic, legal, ethical and discretionary or philanthropic.

On the other hand the *stakeholders’ theory* refers to those relations between the company and all the various groups inside and outside the organization who have interest in it. This theory is based on the premise that the stronger the companies’ relationships are with other interest parties, the easier it will be to meet its business objectives. Stakeholders’ theory contributes to the corporate sustainability concept by bringing supplementary business arguments as to why companies should work toward sustainable development.

*Accountability Theory.* Accountability is a concept in ethics with several meanings. Regarding corporate governance it means the ethical responsibility to provide an

account or reckoning of the actions for which one is held responsible. The contribution of corporate accountability theory is that it helps define the nature of the relationship between corporate managers and the rest of society. It also sets out the arguments as to why companies should report on their environmental, social, and economic performance, not just financial performance.

The early '90s have bring in corporate reporting a new trend of sustainability reporting. The new concept have been adopted especialy by the MNC's. These companies had reorganized their disclosure policy and near by financial information they started to disclose information regarding their economic, environment and social performance.

### 3 Research design, methodology and data collection

In this part of our study to exemplify the disclosure' behaviour of Romanian companies we examine Corporate Social Responsibility reporting trends among the Bucharest Stock Exchange listed companies. The population investigated in the present paper consists of all BSE listed companies.

Based on a quantitative content analysis the goal of our study is to find out if Romanian BSE listed companies disclose information regarding social responsibility within their annual reports or as a stand-alone report. We investigate all companies listed on BSE. Because the companies that are not actively traded are not disclosing information with a constant frequency or they are not disclosing at all we have excluded these companies. Our sample consists of all listed companies that are actively traded and disclose at least one type of information about environment, social responsibility or sustainability at the end of each year of the period 2006-2008, as presented in the Table 1.

Table 1.  
Sample companies

<b>Number of companies</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Listed on BSE	100	91	104
Actively traded	58	59	68
Non-actively traded	42	32	36
That are not disclosing CSR information	52	51	58
<b>Sample companies</b>	<b>6</b>	<b>8</b>	<b>10</b>

Publication of social responsibility information is not regulated on Romanian market thus we gather information from the Annual Reports of the listed companies, from the stand alone Corporate Responsibility, Sustainability or Environment reports, from the companies websites and from a secondary source: the website of Romanian National Securities Commission. For finding information about companies social

responsibility, the content of the mentioned sources was investigated for the period 2005- 2007 according with Weber (1990) guidelines.

We were interested to find out how Romanian companies are disclosing CSR information and what are the basic instruments of CSR they are using and to what extent they are disclosing CSR information. For this reason we look if BSE listed companies are disclosing information about: environment and social policy, standards used for CSR reports and have been certify by an authorized organization.

For measure the extent to which Romanian companies are publishing information about CSR a disclosure index was built for each year. We have chosen an item-based approach, for building the index, following the models of Buzby (1975) and Cooke (1989) that were the firsts that have developed the concept of “disclosure index” and many other authors that have used this kind of index in their research (Chavent, et al., 2006; Popa et al., 2008a,b). We have built a composite index for each company from our sample using un-weighted item. All disclosed items investigated in this study (see Figure 1) were considered equally important. We have assign the value of “one” to every item disclosed on the company’s annual report and value “zero” otherwise. The disclosure index (CSRI) used to measure the level of CSR disclosure is determined with the formula:

$$ScoreCSRI = \sum_{i=1}^{14} CSRI_i \quad (1)$$

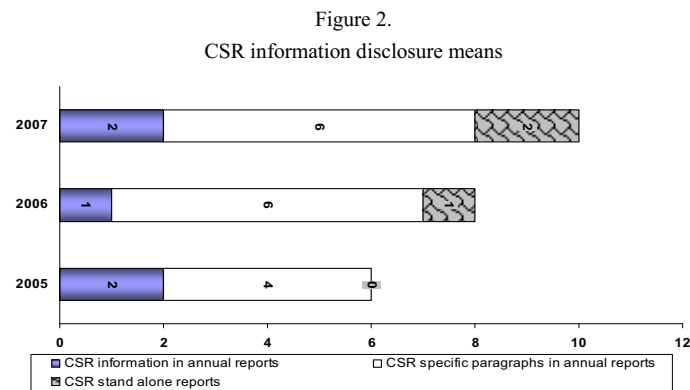
The 14th CSR items that we take in consideration in measuring CSR disclosure index and Romanian companies are disclosing on voluntary bases are presented in the figure below (Figure 1). The items are divided in four groups: information about company’s environmental policy, social policy, and distinctly standards used for elaborating CSR reports and if they have a CSR assurance report.

Figure 1.  
CSR disclosure



#### 4 Findings regarding CSR disclosure

The preliminary results of our investigation on BSE listed companies showed that preferred means for disclosing CSR information are specific paragraphs of companies' annual reports and less CSR stand alone reports (Figure 2).



From 2006, Romanian companies started to elaborate stand-alone environment and CSR reports and to use standards for CSR reporting.

Our findings are summarized in the Figures 3 and 4 that present the level of disclosure regarding environmental and social policy of the companies. We may observe that BSE companies prefer to disclose more information about their social involvement than about their environmental implication, even though the companies that are disclosing CSR information are with two exceptions from sectors that have great impact on the environment such as: refining, metallurgy, electricity transmission and pharmaceuticals. The two others companies are from the banking sector.

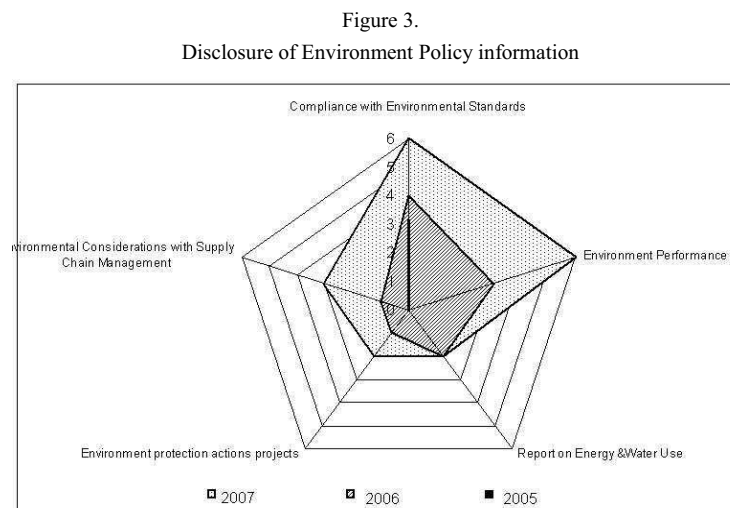
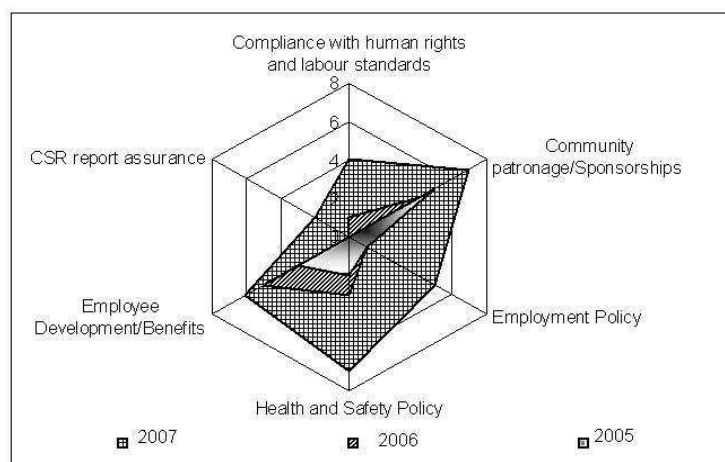


Figure 4.  
Disclosure of Social Policy information



Under these circumstances, when CSR information start to be disclosed more and more also by some Romanian companies, further argument is required to establish an assurance including social and environment aspects in order to maintain the reliability of CSR reports. If CSR report is assured, it has a better chance of being credible, and enhancing the trust of the stakeholders in the reporting and in the company itself. CSR assurance purpose is to assure that the report is accurate and relevant. CSR assurance is something newer in Romanian practice, only 2 companies starting to include an assurance statement of their CSR reports from 2007.

Some companies use CSR methodologies as a strategic tactic to gain public support for their presence on capital markets. Various reasons like: become more accountable, responsible and sustainable, obtain a greater comparability across the sectors, drive companies to use standards for CSR reporting. CSR as a part of firms' reporting system is regulated world-wide by accepted corporate social responsibility reporting standards like: AA1000, GRI, ISO 140001, OHSAS, that are process or/and disclosure standards, guidelines on what and how companies should report for achieving the goal of sustainable development. In the table below (Table 2) we present the situation about the number of BSE listed companies that are using in their reporting CSR standards and which standards are used.

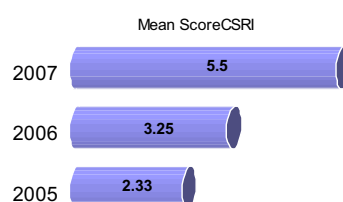
Table 2.  
Standards used for CSR reports

Specification	2005	2006	2007
GRI	0	0	1
ISO 140001	0	1	2
OHSAS	0	0	2
Standards used for CSR reports – no. of companies	0	1	3



It may be observed from the above results that only a small part of the Romanian listed companies are disclosing CSR information. Even the mean ScoreCSRI (figure 5) have doubled for 2007 reports compared with 2005, the mean Score of CSR Index is less than a half of the maximum possible ScoreCSRI (which is 14).

Figure 5.  
Level of CSR disclosure measured with Mean Score CSRI



## 5 Conclusions and directions for future research

It is worth mentioning that one of the features of domestic companies that are operating in the ex-communist countries is that shareholders and employees are considered the main stakeholders; the other stakeholders like government and local communities are considered having less interest.

This suggests that Romanian companies are focusing mainly on the internal aspects of their operations, referring to everything that is directly linked to their bottom line and employee welfare. The fact that external stakeholders are considered far less important could be explained by the tradition of limited empowerment of the civil society in general, which do not exert considerable influence on private sector activities. In addition, the declining role of government as a result of the privatization process and market liberalization has contributed to such development.

In Western European countries, companies due to the pressure from stakeholders and the desire to avoid public scandals started producing social and environmental reports. Voluntary disclosure has become part of the operational culture of many companies all over the world – a trend, which is also evident to some extend among leading enterprises in Romania (Popa, Farcane and Pop, 2008).

The basic instruments of CSR such as: values statements, codes of conducts or ethics, social responsibility reporting, auditing and certification are rather hard to find in Romanian companies.

The findings suggest that the triple bottom line concept exists, but it is not very advanced in BSE listed companies. In order to achieve further improvement, government have to make social and environmental reporting mandatory and raise awareness by providing clear reporting guidelines in the field.

Our survey of the companies listed on BSE actively traded showed that disclosure of CSR information does not generally belong to the strengths of Romanian companies at the present. However, we found companies whose CSR related information provision and disclosures considerably exceeded the average.

Future direction research will be oriented to the investigation of the link between ethics and CSR for Romanian listed companies, the measurement of the influence of cultural factors upon the corporate governance and CSR practices, a critical analysis of the relationship between CSR-MNC's and accounting harmonization.

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